

STATE OF WISCONSIN
COURT OF APPEALS
DISTRICT IV

Case No. _____
Dane County Circuit Court Case No. 10-CV-1576

IN THE MATTER OF THE REHABILITATION OF:
SEGREGATED ACCOUNT OF AMBAC ASSURANCE
CORPORATION and TED NICKEL AND OFFICE OF THE
COMMISSIONER OF INSURANCE,

Plaintiffs-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
(FANNIE MAE),

Defendant-Petitioner,

WELLS FARGO BANK/TRUSTEE OF BONDHOLDERS,
AURELIUS CAPITAL MANAGEMENT LP, FIR TREE
INC., KING STREET CAPITAL MANAGEMENT LP,
MONARCH ALTERNATIVE CAPITAL LP, STONEHILL
CAPITAL MANAGEMENT LLC, RMBS
POLICYHOLDERS, EATON VANCE MANAGEMENT,
NUVEEN ASSET MANAGEMENT, RESTORATION
CAPITAL MANAGEMENT LLC, STONE LION CAPITAL
PARTNERS LP, LVM BONDHOLDERS, THE BANK OF
NEW YORK MELLON, FEDERAL HOME LOAN
MORTGAGE CORPORATION (FREDDIE MAC), WELLS

FARGO BANK/TRUSTEE OF RMBS CERTIFICATE
HOLDERS, HSBC BANK USA, NATIONAL
ASSOCIATION, DEUTSCHE BANK NATIONAL TRUST
COMPANY, DEUTSCHE BANK TRUST COMPANY
AMERICAS, US BANK NATIONAL ASSOCIATION,
BANK INSUREDS, BANK OF AMERICA NA, DEPFA
BANK PLC, ASSURED GUARANTY CORPORATION
AND GOLDMAN SACHS & CO., INC.,
KNOWLEDGEWORKS FOUNDATION AND
TREASURER OF THE STATE OF, ONE STATE STREET
LLC, PNC BANK, NA, ALL STUDENT LOAN AND
LLOYDS TSB BANK PLC, CUSTOMER ASSET
PROTECTION COMPANY, WILMINGTON TRUST
COMPANY AND WILMINGTON TRUST FSB, GCM
OPPORTUNITY FUND LP, GLENVIEW CAPITAL
PARTNERS LP, GLENVIEW INSTITUTIONAL
PARTNERS LP, GLENVIEW CAPITAL MASTERS FUND
LTD., GLENVIEW CAPITAL OPPORTUNITY FUND LP,
and GLENVIEW OFFSHORE OPPORTUNITY MASTER
FUND LTD.,

Defendants.

PETITION & MEMORANDUM FOR LEAVE TO APPEAL
THE JUNE 4, 2012 ORDER OF THE CIRCUIT COURT FOR DANE
COUNTY, THE HON. WILLIAM D. JOHNSTON, LAFAYETTE
COUNTY CIRCUIT COURT JUDGE, PRESIDING BY JUDICIAL
ASSIGNMENT ORDER

In the alternative to the Notice of Appeal to be filed with the Circuit Court, the Federal National Mortgage Association (“Fannie Mae” or “Petitioner”) petitions the Court of Appeals, District IV, for leave to appeal from the order (“Order”) entered on June 4, 2012, in Dane County Circuit Court Case No. 10-CV-1576, the Honorable William D. Johnston presiding by judicial assignment, granting the Amended Motion to Approve Purchase of Surplus Notes (“Motion”), filed by the Commissioner of Insurance of the State of Wisconsin as Rehabilitator of the Segregated Account of Ambac Assurance Corporation (“Rehabilitator”). Petitioner believes that the Order is final for purposes of appeal and intends to file a Notice of Appeal with the Circuit Court. This petition is filed out of an abundance of caution, in the event this Court determines the Order to be non-final.

Petitioner has already appealed certain orders of the Circuit Court in these proceedings that allow the Rehabilitator to violate Wisconsin statutes governing insurer rehabilitation and liquidation proceedings. The Order unlawfully permits Ambac Assurance Corporation (“Ambac”) to pay lower priority claimants—in this instance, bank counterparties to credit default swap and other contracts (“the Bank Group”) that the Bank Group had with a non-insurance subsidiary of Ambac, Ambac Credit Products, LLC

(“ACP”)—while insureds’ policy loss claims, which have a higher priority under Wisconsin law, remain unpaid and have no reasonable likelihood of being paid in full. Specifically, the Order permits Ambac to pay millions of dollars to the Bank Group while the claims of the Petitioner remain unpaid. The Order permits Ambac to pay approximately \$188 million to repurchase surplus notes that were issued to certain banks in the Bank Group as part of the Bank Group settlement.

The Order violates Wisconsin law and should be reversed by this Court.

STATEMENT OF THE ISSUES

1. Did the Circuit Court err in authorizing Ambac to pay millions of dollars to lower priority claimants while policyholder claims are unpaid, in violation of Wisconsin’s absolute priority rule?

STATEMENT OF THE FACTS NECESSARY TO AN UNDERSTANDING OF THE ISSUES

This Court already has an understanding of the nature of this litigation from previously filed briefs. (See Order in Appeal No. 11-AP-561.) Accordingly, for purposes of this petition, Petitioner submits only a limited factual recitation and respectfully refers the Court to the Appellants’

Consolidated Opening Brief in Appeal No. 11-AP-561, filed on June 17, 2011, for a more complete discussion of the rehabilitation proceedings.

Rehabilitation Proceedings. On March 24, 2010, the Wisconsin Office of the Commissioner of Insurance (“OCI”) petitioned the Circuit Court for entry of an Order of Rehabilitation for the Segregated Account of Ambac Assurance Corporation. On October 8, 2010, the Wisconsin Commissioner of Insurance, as rehabilitator of the Segregated Account, filed a proposed Plan of Rehabilitation for the Segregated Account. On January 24, 2011, the Circuit Court issued its Decision and Final Order Confirming the Rehabilitator’s Plan of Rehabilitation, with Findings of Fact and Conclusions of Law (“Confirmation Order”). Interested parties, including the Petitioner, timely filed Notices of Appeal of the Confirmation Order on or before March 10, 2011. Those appeals remain pending, including appeals of the Bank Group Settlement. (*See* Court of Appeals Case Nos. 2010 AP 1291, 2010 AP 2022, 2010 AP 2835, 2011 AP 561, 2011 AP 1486, and 2011 AP 2708. (the “Pending Ambac Appeals”).)

The Bank Settlement Agreement. On June 7, 2010, Ambac, Ambac’s parent, ACP and the Bank Group entered into a settlement agreement which effected the commutation of all of ACP’s outstanding

credit default swaps in respect of ABS CDOs with respect to the Bank Group, and all of Ambac's related financial guaranty exposure ("Bank Group Settlement"). (See Annual Report on the Rehabilitation of The Segregated Account of Ambac Assurance Corporation filed on May 24, 2012, p. 3; Exh. H - 10.¹) In exchange for Ambac and ACP commuting \$16.5 billion of net par exposure, Ambac transferred to the Bank Group, in the aggregate, \$2.6 billion in cash and \$2 billion of surplus notes newly issued by Ambac (the "Bank Settlement Surplus Notes"). (*Id.*) Ambac also paid \$96.5 million to the Bank Group to commute certain other obligations, including certain non-ABS CDO obligations, with par amounting to \$1.4 billion, in full satisfaction, but partial payment, of such obligations. (*Id.*) In addition, subject to certain conditions, Ambac is pursuing the commutation of certain other non-ABS CDO exposures with par amounting to a maximum of \$702 million for an amount up to approximately \$45 million. (*Id.*)

Averaging the valuations of Ambac's independent appraiser, the Bank Group Settlement ultimately paid the Bank Group 43.3% of the

¹ References to "Exh. ___" refer to the pages in the Exhibits to Petition for Leave to Appeal, filed contemporaneously herewith.

present value of expected losses, with 24.5% in cash and 18.8% in notes.

(Id.)

Certain parties objected to the Bank Group Settlement. On June 2, 2010, this Court denied the RMBS Policyholders' motion for injunction of the Bank Group Settlement pending appeal. Fannie Mae adopts the positions taken by the RMBS Policyholders and other interested parties in opposition to the Bank Group Settlement, as those positions all serve as additional bases for this Court to reverse the June 4, 2011 Order of the Circuit Court. (*See* R 38, R 42; R 43, R 104 in the Pending Ambac Appeals for the positions adopted by Fannie Mae.)

The Bank Group Surplus Notes. On May 16, 2012, the Rehabilitator filed with the Rehabilitation Court a Notice of Motion and Motion to Approve Purchase of Surplus Notes, which was subsequently amended by motion filed on May 23, 2012. (Exh. B; Exh. C.) The Rehabilitator sought approval to permit Ambac to purchase approximately \$789 million in principal amount of Bank Settlement Notes for an aggregate cash payment of approximately \$188 million. (Exh. C – 2 & C – 7.) Fannie Mae timely filed an objection to the Motion (“Objection”). (Exh. D.) Other parties that previously appealed the Circuit Court’s Order

Denying Objections to the Bank Settlement, filed a Statement that reserved all their rights on appeal. Freddie Mac, Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital, L.P., King Street Capital Master Fund, Ltd., Monarch Alternative Capital LP, and Stonehill Capital Management LLC (collectively, “the RMBS Holders”) filed such a Statement (Exh. E; Exh. F), as did Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas (Exh. G.)

On June 4, 2012, the Circuit Court held a hearing on the Motion and granted the Motion and entered the Order. (Exh. A - 1.)

**STATEMENT SHOWING NECESSITY OF
IMMEDIATE REVIEW**

Immediate review should be granted not only because the Order is a final order that may be appealed as a matter of right under Wis. Stat. § 808.03(1), but also because this case satisfies the following criteria for discretionary review under Wis. Stat. § 808.03(2): (1) an immediate appeal will protect the Petitioner from substantial and irreparable injury; (2) an immediate appeal will clarify an issue of general importance in the administration of justice; and (3) an immediate appeal will provide

guidance for further proceedings in the Rehabilitation. Petitioner also has a substantial likelihood of success on the merits.²

I. ALTHOUGH THE ORDER IS FINAL AND APPEALABLE AS OF RIGHT, THIS MOTION IS FILED IN THE ALTERNATIVE OUT OF AN ABUNDANCE OF CAUTION.

A judgment or order is final for purposes of appeal if it “disposes of the entire matter in litigation as to one or more of the parties.” Wis. Stat. § 808.03(1). To meet this requirement, the judgment or order must either “explicitly dismiss[] the entire matter in litigation as to one or more parties” or “explicitly adjudg[e] the entire matter in litigation as to one or more parties.” *Tyler v. The Riverbank*, 2007 WI 33, ¶ 17, 299 Wis. 2d 751, 728 N.W.2d 686. In this case, the Order is final because it resolves the matters in litigation as to all of the parties before the Circuit Court.

In authorizing Ambac to repurchase the Bank Group Settlement Surplus Notes, the Circuit Court has permitted Ambac to pay in full all consideration that is due and owing to certain banks under the Bank Group Settlement. The payment of surplus notes was always deemed to be a deferred payment obligation of Ambac, payable to all surplus noteholders

² See Michael S. Heffernan, Appellate Practice and Procedure in Wisconsin, § 9.2 (5th ed. 2011).

parri passu if and when funds existed, but only after the payment in full of the cash portion of policyholder claims. By permitting Ambac to pay cash now for the Bank Group Settlement Surplus Notes, the Order adjudges the entire dispute relating to the Bank Group Settlement Surplus Notes as to all parties affected thereby.

II. EVEN IF THE ORDER IS DEEMED NON-FINAL, THIS COURT SHOULD GRANT THE PETITIONER LEAVE TO APPEAL FROM IT.

Wisconsin Statute § 808.03(2) provides that the Court of Appeals may review the Circuit Court's Order, even if the Court concludes that the Order is non-final, where an immediate appeal will:

- (a) Materially advance the termination of the litigation or clarify further proceedings in the litigation;
- (b) Protect the petitioner from substantial or irreparable injury; or
- (c) Clarify an issue of general importance in the administration of justice.

Wis. Stat. § 808.03(2). An immediate appeal in this case will protect the Petitioner and other holders or beneficiaries of insurance policies issued by Ambac from irreparable harm, clarify an issue of general importance in the administration of justice, and will provide guidance for further proceedings in the rehabilitation case.

A. An Immediate Appeal Will Protect Fannie Mae and Other Policyholders From Substantial And Irreparable Injury.

Wisconsin law mandates that “every claim in each class shall be paid in full or adequate funds retained for the payment before the members of the next class receive any payment.” Wis. Stat. § 645.68. Policyholder claims, such as those of the Petitioner, are at a higher priority than other creditors. Policyholder claims are Class 3, while general creditor claims are Class 5. *See id.* Under Wisconsin law, the policyholder claims must be paid in full before the general creditor claims are paid. *Id.* Here, Ambac already has paid billions of dollars to the Bank Group and, under the Order, will be paying millions of dollars more to certain banks in the Bank Group or their successor noteholders, despite the fact that they are several classes below policyholders under Wis. Stat. § 645.68. Those are funds that would otherwise be available to pay Fannie Mae and other insureds on account of their loss claims.

B. An Immediate Appeal Will Clarify An Issue Of General Importance In The Administration Of Justice.

An immediate appeal is necessary to clarify the Circuit Court’s jurisdiction to enter an order that affects the parties on a matter that already is on appeal to this Court. Interlocutory review is clearly warranted in this

case, as it presents that limited instance where the necessity of immediate review outweighs the general policy against the piecemeal disposal of litigation. This is especially true given the impact of the June 4, 2012 Circuit Court Order, along with the number of Pending Ambac Appeals before the Court of Appeals. No disruption or delay will result in the Circuit Court as a result of this appeal.

Immediate judicial review is necessary to protect this Court's jurisdiction to determine the legality of the Bank Group Settlement and Wisconsin statutory requirements for formal insurer delinquency proceedings.

C. An Immediate Appeal Will Provide Guidance For Further Proceedings In The Rehabilitation.

An immediate appeal is necessary to clarify whether the Rehabilitator can proceed with repurchasing surplus notes issued pursuant to the Bank Group Settlement or other claims settlements before Class 3 claimants are paid in full, or at least until the cash portion of their claims are paid in full. Whether the Rehabilitator can lawfully do so significantly impacts the manner in which the Rehabilitator proceeds with the rehabilitation of the Segregated Account, and whether claims-paying assets will be further depleted in an unlawful manner.

D. An Immediate Appeal Is Not Contrary To The Policy Against Permissive Appeals.

Petitioner is well aware that petitions for leave to appeal non-final orders are not granted lightly. However, this situation is distinct from the rationale which discourages interlocutory appeals.

The purpose of the requirement that a final order or judgment be entered before an appeal of right may be taken is twofold. First, the rule is designed to protect trial proceedings by avoiding unnecessary interruptions and delays caused by multiple appeals. *Heaton v. Independent Mortuary Corp.*, 97 Wis. 2d 379, 395, 294 N.W.2d 15, 23 (1980). Second, the rule reduces “the burden on the court of appeals by limiting the number of appeals to one appeal per case and allowing piecemeal appeals only under special circumstances set forth in Wis. Stat. §808.03(2).” *Id.* 97 Wis. 2d at 395-96, 294 N.W.2d at 23.

In this instance, there are six Pending Ambac Appeals. The trial court proceedings have continued forward despite those appeals. The issues arising from the Order are related to those in the Pending Ambac Appeals. Given the unique procedural posture of this case, an immediate appeal of the Order is justified and should be allowed.

III. THERE IS A SUBSTANTIAL LIKELIHOOD THAT THE PETITIONER WILL SUCCEED ON THE MERITS OF THE APPEAL.

To succeed on a petition for an immediate appeal, a petitioner must show that it is likely to succeed on the merits. M. Heffernan, Appellate Practice And Procedure In Wisconsin, § 9.2 (1995). The Petitioner submits that the Circuit Court's Order should be reversed on the following grounds.

A. The Circuit Court Erred In Approving Ambac's Decision To Pay Approximately \$188 Million To Creditors Lower in Priority To Policyholder Claims, In Violation Of Wisconsin's Absolute Priority Rule.

The Petitioners will demonstrate on appeal that the Circuit Court erred in approving the Rehabilitator's Motion allowing Ambac to pay certain Bank Group Settlement parties millions of dollars ahead of policyholder claims and in violation of Wisconsin's absolute priority rule. When an insurance company's financial condition will result in loss to claimants, Wisconsin's regulatory scheme provides for the "[e]quitable apportionment of [that] unavoidable loss." Wis. Stat. §645.01(4)(d). That equitable apportionment is accomplished through Wisconsin's priority scheme found in Wis. Stat. §645.68. Policyholder loss claims (Class 3) come ahead of general creditor claims (Class 5). *Id.* Thus, policyholder

claims must be paid in full before lower priority claimants receive anything.

Id.

By its Order, the Circuit Court approved the Rehabilitator's payment of \$188 million to repurchase surplus notes that Ambac issued as consideration for the Bank Group Settlement. This is on top of the \$2.6 billion in cash previously paid under the Bank Group Settlement. (Exh. H - 10.)

This substantial payment to repurchase surplus notes while policyholder claims remain unpaid, violates Wisconsin's absolute priority rule embodied in Wis. Stat. § 645.68. The Petitioner and others previously briefed issues involving the absolute priority rule in Appeal No. 11-AP-561, in which they challenged the legality of the Plan of Rehabilitation. (*See* Appellants' Consolidated Opening Brief at 46-59 (§ III.A).)

Accordingly, Bank Group claims should be treated as subordinate to those of policyholders under Wis. Stat. § 645.68. But even if the Bank Group claims are Class 3 claims, as the Rehabilitator contends, their claims are not entitled to *superior* treatment to the claims of Fannie Mae and other policyholders in the Segregated Account. Yet, that is precisely the result of the Order, which approved Ambac's purchase of surplus notes from certain

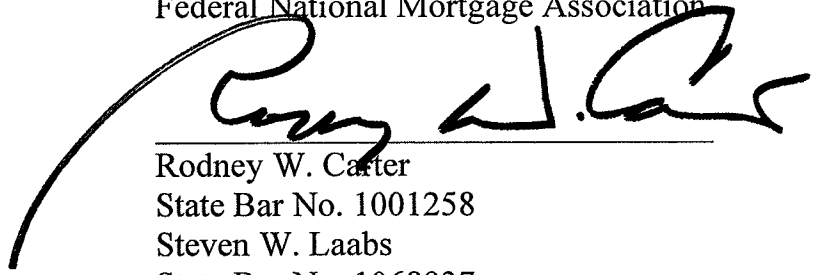
banks that already have received a substantial cash payment pursuant to the Bank Settlement Agreement *before* Fannie Mae and other policyholders in the Segregated Account have had at least the cash portion of their claims paid in full. Given that the Plan of Rehabilitation approved by the Circuit Court provides for Fannie Mae and other policyholders in the Segregated Account to receive 25% of their permitted claims in cash and 75% in surplus notes (Exh. H – 11-12), it is particularly inequitable to allow the surplus notes of the Bank Group to be paid before Class 3 claimants have received any payment whatsoever.

CONCLUSION

If the Court agrees that the Circuit Court's Order is final for purposes of appeal, this petition may be dismissed as moot. In the alternative, and for the reasons given above, Petitioner respectfully requests that the Court grant this petition and accept the Petitioner's appeal on an interlocutory basis.

Dated this 18th day of June, 2012.

DAVIS KUELTHAU, s.c.
Attorneys for Defendant-Petitioner
Federal National Mortgage Association

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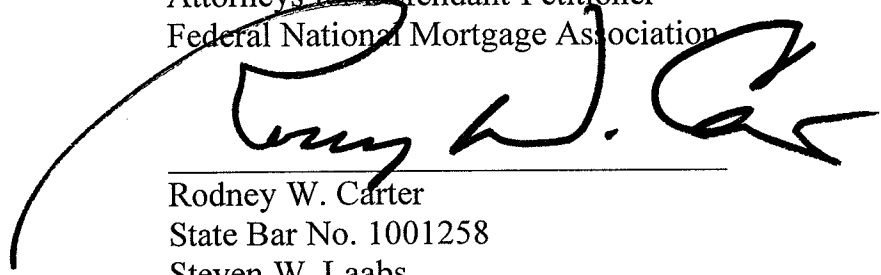
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STATEMENT PURSUANT TO WIS. STAT. § 809.50(4)

I hereby certify that this Petition & Memorandum for Leave to Appeal the June 4, 2012 Order of the Circuit Court for Dane County conforms to the rules contained in Wis. Stat. § 809.50(1) for a petition produced using a proportional serif font: Minimum printing resolution of 200 dots per inch, 13 point body text, 11 point for quotes and footnotes, leading of minimum 2 points, maximum of 60 characters per full line of body text. The length of this document is 2,738 words.

Dated this 18th day of June, 2012.

DAVIS KUELTHAU, s.c.
Attorneys for Defendant-Petitioner
Federal National Mortgage Association

A large, stylized handwritten signature in black ink, appearing to read "Rodney W. Carter", is written over a horizontal line. The signature is written in a cursive, flowing style.

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